



GOVERNOR'S TRANSACTION PRIVILEGE TAX SIMPLIFICATION TASK FORCE ONLINE RETAIL WORKING GROUP MINUTES

Tuesday, August 14, 2012

1:30 PM

1820 W. Washington, St. #200, Conference Room 101
Phoenix, Arizona 85007

A public meeting of the Transaction Privilege Tax Simplification Task Force was convened on August 14, 2012 in Conference Room 101, 1820 West Washington, St. #200, Phoenix, Arizona 85007. Notice having been duly given. Present and absent were the following members of the Task Force.

Members Present

Michael Hunter (Chair)
John Olsen
Miguel Teposte
Tom Belshe
Steve Barela
Kevin McCarthy

Lynne Herndon
Keely Hitt
Vince Perez
Senator John McComish
Representative Rick Gray

Members Absent

Linda Stanfield

Staff Present

Lorna Romero, Governor's Office
Lindsay Scornavacco, Governor's Office

1. Call to Order

Michael Hunter called the meeting to order at 1:32 p.m.

2. Welcome & Introduction of Working Group Chair

Mr. Hunter explained the format of working group meetings. He emphasized that these working groups are very focused on giving the public the opportunity to be on record so that the Task Force can understand the public interest and perspective. Mr. Hunter introduced Dennis Hoffman as the working group chairman for the Online Retail Working Group.

3. Overview and Scope of Working Group

Mr. Hoffman clarified that the opinions and personal positions expressed in his papers and publications do not reflect the direction of the working group. He continued that the focus of this group is not about raising revenue or improving the current fiscal situation of the state but looking at the TPT base with respect to remote sales. Mr. Hoffman expects the working group to make recommendations which the Legislature may use to deal with fiscal problems should they occur.

Mr. Hoffman expressed he would like the working group to look at the issue of Arizona's tax base

and the Marketplace Fairness Act. He clarified that there is a distinction between ecommerce and remote sales and that ecommerce is a portion of all remote sales. He discussed that in a Wall Street Journal article data was used and labeled ecommerce when the actual numbers were for all remote sales and he cautioned the working group to be careful when discussing the issue. He believes this group can make recommendations to eliminate distortions if the group would like to go in such a direction. He continued that if completely eliminating these distortions is too noble of a goal for the group, then the group may recommend stages of remedy.

a) Working Group Discussion and Public Comment

Mr. Hoffman asked the Task Force and the public if they had anything to add to this agenda item.

Laura Magnus from the Arizona Lodging and Tourism Association introduced Debbie Johnson from the Arizona Lodging and Tourism Association and Mitch Bryk from Starwood Hotels.

Debbie Johnson from the Arizona Lodging and Tourism Association announced that she was available as a resource to the Task Force on the issue of booking hotels through online travel companies. She continued that she can answer questions about the collection of tax versus what is paid to the state or municipality.

Mr. Hoffman asked what the tax consequence is if he were to book a hotel room through Expedia instead of directly through the hotel.

Debbie Johnson from the Arizona Lodging and Tourism Association answered that Expedia only pays \$80 for a room that they may sell for \$100. Expedia then pays the tax on the \$80 price and not the \$100 price; Expedia pays \$8 in taxes and not \$10. That two dollar differential adds up to hundreds of millions of dollars around the country.

Mitch Bryk from Starwood Hotels announced that he is available as an industry resource. He offered to present an hour and a half long PowerPoint presentation to model how things work if someone books a room directly through Starwood, the Marriot or any other hotel. He continued that online travel companies get a discounted room rate and then charge what they call a facilitation fee. These companies then pay taxes on the discounted rate and remit the two dollar difference between what Starwood and the online travel companies pay.

Senator McComish asked what the consumer sees on the invoice from the online travel company.

Mitch Bryk from Starwood Hotels answered that the invoice is bundled to reflect a tax and service fee without allowing the consumer to see the breakout.

Representative Gray asked if this hotel tax rate is the same across the board for every city.

Mitch Bryk from Starwood Hotels responded that rates may vary.

4. Presentation from Department of Revenue

Mr. Hoffman introduced Christie Comanita from the Department of Revenue.

Ms. Comanita delivered a presentation on the taxation of online retail.

Mr. Hoffman, regarding a point in Ms. Comanita's presentation where she said something is subject to tax depending on nexus, asked if tax is due under current law and is simply not collected.

Ms. Comanita answered that there is nothing in the tax base that would be considered not taxable simply because it was purchased online. She continued that it only becomes a question of whether TPT or use tax is owed.

Ms. Comanita explained that there are certain simplification requirements under the federal legislation that is being discussed. She stated that one of the efforts at the federal level requires states to join the National Streamline Sales Tax Group. The more popular bill supported by larger states is H.R. 3179 that does not require states to join the group. This bill still has the minimal requirements that state and local levels must have one single administration, that state and local levels have a single base and that states have a small seller exemption. These are significant because they have been the state's hurdles in the past. Ms. Comanita continued that central administration is a huge issue for state and local governments.

Mr. Hoffman asked if state and local governments need uniform tax rates.

Ms. Comanita responded that under the streamline provision there needs to be a single rate per jurisdiction. Phoenix currently has one rate with the exception of taxes on food. Under the federal legislation there is no ability to have an exception for food.

Mr. Hoffman asked if Phoenix and Scottsdale could have different rates.

Ms. Comanita answered that they could have different rates. She pointed out that another issue is having a single base. Arizona doesn't tax food; it doesn't have a zero tax rate on food. She continued that under federal legislation to have a common base Arizona would have to impose a tax on food at the state level and then have the tax rate be zero percent.

Tom Belshe responded that he had a different view on the issue and suggested that the state could move food out of the retail category and not have an issue.

Ms. Comanita stated that that situation may be possible under the streamline regime but that she was not sure if that flexibility would exist under other federal legislation.

a) Working Group Discussion and Public Comment

Mr. Hoffman asked if it was Ms. Comanita's opinion that in a considerable number of situations it is unlikely that tax is paid.

Ms. Comanita answered that she agreed with that opinion and explained that there is a misconception even with retailers exclusively operating in Arizona that if an item is sold online there is no tax owed. She continued that this needs to be clarified so that at least the in-state retailers would be in compliance.

Mr. Hoffman presented another scenario where a large business has an accounting system to trigger use tax. He asked if there was any evidence that inequities exist between large businesses and small

businesses or individuals with regards to their payment of use tax.

Vince Perez answered that businesses are more inclined to report use tax than individuals. He continued that auditing individuals is very difficult when the population of Arizona is compared to the size of the audit division. There are 300,000 businesses compared to multimillions of people. He stated that the fundamental most important question is if where the vendor is making the sale is liable for TPT. If it is liable, then that is where the tax should be collected and remitted.

Representative Gray asked if use tax is tracked or if it is lumped in with other taxes.

Mr. Perez answered that the Department of Revenue tracks two different codes, one for out-of-state removed from inventory and one for in-state.

Representative Gray asked to how much this amounted.

Elaine Smith from the Department of Revenue answered that in FY11 there was \$229 million in use tax. In FY12 there was a growth in use tax that was higher than \$320 million. All of this money goes into the general fund. She commented that the FY12 report is not complete.

Lynne Herndon asked for an example of a business having nexus without having a physical location in the state.

Ms. Comanita gave the example of a business having a sales representative in the state. Any continuing activities that enhance the business and allow the business to expand in the state are subject to TPT.

Ms. Herndon asked if mass marketing would trigger nexus.

Mr. Perez said that would be sufficient to trigger nexus.

Steve Barela explained how Arizona Public Service (APS) buys equipment all over the country and that the company constantly has to tell businesses to send a correct invoice with the proper tax. This process generally goes back and forth and there is one person within the company who calls businesses to have APS billed properly.

Mr. Perez emphasized that 100% of use tax is contributed to the general fund, but with TPT there are distributions.

Kevin McCarthy commented that in the business environment there are usually tax professionals dealing with vendors. If an individual goes online he or she may not have any idea if he or she has paid sales tax. He continued that an individual may see a sign advertising no sales tax as a marketing tool, but that this does not mean the consumer has not paid sales tax. The individual who shopped at this store with that advertisement does not then owe use tax. He claimed that it is an understatement that administration of this issue is problematic. Mr. McCarthy stated that this is not as big of a problem for businesses like Mr. Barela's that have people to do the work for them.

Mr. Hoffman asked Mr. Barela what would help ease administrative burdens on his company.

Mr. Barela answered that he did not think there was a simple fix.

Miguel Teposte asked if small and medium sized businesses generally have the same tax knowledge as large companies like APS.

Mr. Barela answered no.

Mr. Perez responded that there is a level of complexity in large businesses where there are people well versed in tax law and explained that that does not happen with small and medium sized businesses.

Representative Gray commented that with small businesses their forte is their business and not taxes. Some may say a tax form is simple, but to a small business person it can be very confusing. Someone may be an expert in his or her field but constantly second guessing his or herself with taxes.

Senator McComish asked when the tax applies to individuals that are selling items on the internet. He continued that some of these individuals just about have a business of their own.

Ms. Comanita responded that if they meet the definition then they are subject to TPT. She explained that if someone has a garage sale it is not considered that he or she is engaging in business. If a person is operating a website and routinely puts items up for sale, then it is considered that he or she is engaging in business. The issue is having the resources to track these websites.

Senator McComish asked if these individuals would be subject to any federal taxes.

Ms. Comanita answered that she believes they would fall under the small seller exemption.

Mr. Hoffman underscored that taxes are still due on these transactions but that this size is just exempt. In this manner, distortions remain but are hopefully modest.

Mitch Bryk from Starwood Hotels commented that there is a misconception that if something is sold on the internet it is tax free. This comes from the Internet Tax Freedom Act passed in 1998. He continued that the collection mechanism is the problem. Large hotels have to determine if tax has been paid and if it has not they then have to accrue and remit the use tax to the state and local jurisdictions. Hotels have to go item by item to determine if the correct rate has been charged and it is a very difficult, manual process. Mr. Bryk stated that the Arizona Legislature passed a law to require taxpayers to remit use tax for internet purchases on their tax returns. He continued that individuals could simply look at their credit card statements and see what online purchases were made and if tax was paid. Mr. Bryk said the issue is that the state is asking for voluntary compliance.

Mr. Hunter interjected that the provision enacted by the Legislature was very unpopular and was repealed the next year. He continued that there were examples that this idea would be a problematic exercise and the Legislature quickly realized there were unintended consequences.

5. Presentation from the Arizona League of Cities and Towns

Mr. Belshe gave a presentation on the taxing difference between state and city levels. He commented that his presentation simply points out the differences and that he hopes to come back to a future meeting with recommendations to close the gap between the two levels. Many of the options at the city level are obsolete, but some are still very important. The League of Cities and Towns needs to go through these options one by one to determine if they need to be continued.

a) Working Group Discussion and Public Comment

Mr. Hoffman commented that it is his understanding that it is important to work toward commonality of the base to allow the state of Arizona to take advantage of pending federal legislation. He asked the Department of Revenue and the League of Cities and Towns if there were one or two areas they knew were going to be tough to work through.

Mr. Belshe responded that local option B does not make sense to the state but is something that is important to cities and towns. The criteria for nexus also matters to cities when determining which city receives the money, an issue the state does not have to handle. He continued that how food will be taxed will also be difficult and that the issues are not a matter of a difference in opinion with the state but only that some issues do not apply.

Mr. McCarthy asked if it was possible to have a third column in the handout dedicated to the streamline effort.

Ms. Comanita answered that if the current bill in Congress passes then the streamline effort will not matter. She continued that the streamline effort expands and broadens definitions of terms such as delivery charge. If states have to adopt the streamline definitions then there will be a revenue impact because the exemption is broader. She stated that the group needs to be cognizant of the definitions at the streamline level.

Mr. Belshe asked if it was true that the streamline definitions could also broaden taxability.

Ms. Comanita responded no. The taxability could not be broadened unless the item is already taxed. She continued that the streamline effort is geared toward defining exempt items.

The working group took a 10 minute break.

6. Presentation from the Arizona Retailer's Association

Mr. Hoffman called the meeting back to order at 3:09 p.m.

Jay Kaprosy from the Arizona Retailer's Association gave a presentation on an update of e-fairness in Arizona and at the federal level. He commented that 5,000 retail jobs currently do not exist due to the e-fairness issue. Customers often come into stores to touch and hold a product then leave to buy it online, an act that has been termed showrooming. It is notable that Amazon has been in support of federal legislation because if laws are only made against Amazon then business may trickle out to other competitors. Mr. Kaprosy commented that there should be a sense of urgency when dealing with the issue to prevent significant damage to the retail community.

a) Working Group Discussion and Public Comment

Mr. Hunter assured the public that many of these presentations and materials will be found on the website but that they may not be posted yet. He continued that if anyone wanted something not yet on the website then they could contact the Governor's Office for assistance.

Mr. McCarthy asked what entities were affected by the expanded nexus in 2012.

Mr. Kaprosy responded that there was not opposition to the 2012 legislation. EBay had issues with the 2011 legislation regarding affiliate nexus, but did not bring forward any opposition in 2012. He continued that the straight forward concept of expanded nexus did not bring forward any other online retailers.

Representative Gray asked how it was determined that 5,000 jobs were missing.

Mr. Kaprosy answered that it was not a cumulative number or a number over a certain period of time but just how many are missing from today's economy. He continued that he believes it is a very conservative estimate and that less than one in every four dollars spent online would actually return.

7. Measuring the Economic Consequences

a) Presentation: Dan Court, Pollack Report

Dan Court gave a presentation on the economic and fiscal impact of uncollected taxes on ecommerce in Arizona.

Mr. Hoffman commented that in the Tennessee study the focus is about all remote sales without breaking out ecommerce. He continued that Mr. Court's 2012 estimates are in line for the impacts of ecommerce in the state and that if all remote sales were calculated it would be about double. Mr. Hoffman then asked if it was a fair estimate to conclude that the job consequences would be on the order of magnitude of double also.

Mr. Court responded that this would be a fair estimate.

b) Working Group Discussion and Public Comment

Representative Gray asked if taxing Amazon would translate into the same factor.

Mr. Court responded that the assumptions are not based on Amazon but on all online sales.

Mr. McCarthy commented that this is a job issue for net job losses, pointing out that jobs in the United States are a part of a zero sum game. He asked what level of job loss would occur with taxing ecommerce.

Mr. Court answered that the scope of the study did not estimate online employment in the state.

Mr. McCarthy stated that the incentive to do online transactions in Arizona is very high and that one would assume the impact on online jobs would be higher here.

Mr. Court responded that the study did account for how high the tax rate was in Arizona and how it affected the share of activity in the state.

Mr. Hoffman stated there would be more brick and mortar retail employment but perhaps fewer UPS drivers.

Mr. Kaprosy commented that the retail industry looks at the amount of jobs per million dollars and that brick and mortar retailers employ three to five workers per million dollars sold. Distribution centers employ only one employee per million dollars sold. He continued that Arizona is likely to be a distribution hub as a result of geography, not tax policy.

Tom Johnson from the Department of Revenue asked if the assumption is that taxing online retail will reverse the trend of online purchase behavior.

Mr. Court confirmed there would be a shift.

Tom Johnson from the Department of Revenue asked what other variables would cause the modified behavior other than taxation.

Mr. Court answered that only a minority of customers would shift and that it is expected that 76% of customers would continue to shop online.

Tom Johnson from the Department of Revenue took the \$400 million figure from Mr. Court's presentation and asked if it was practical that every citizen of Arizona is spending \$1,000 on online purchases.

Mr. Court stated that the national data is very reliable and added that the figure is attributed to large businesses in the state and not just individuals.

Mr. McCarthy pointed out that what Mr. Kaprosy and Mr. Court are discussing are two different issues. One is regarding distribution centers, while the other is taxation on remote sellers. He continued that if the legislation being discussed were to be implemented the problem of 5,000 missing jobs would still not be solved. That issue could only be solved in the whole body of ecommerce.

Mr. Hoffman commented that fixing the nexus issue with respect to online only sellers takes a step toward dealing with distortion, but that distortion will get squeezed further down the line. Amazon is backing federal legislation because it is afraid dollars will shift to competitors. He continued that remote sales are important because if only ecommerce is addressed then someone could line up a sale online and make the final purchase over the phone to circumvent the issue.

8. Understanding the Legal Context

Mr. Hoffman stated that a lot of what was to be covered in this agenda item was discussed by Ms. Comanita and that the group would skip agenda item eight, provided there be no objection from the Task Force or the public.

a) Working Group Discussion and Public Comment

No comments were made.

9. Topics for Future Meetings

Mr. Hoffman asked the Task Force members and the public for topics they would like to hear about in future meetings.

a) Working Group Discussion and Public Comment

Representative Gray commented that he would like to hear from the hotel industry.

Bill Molina from the Apollo Group suggested a presentation on the simplification of taxability regarding cloud computing and digital products.

Mr. Belshe reiterated that he would like to come back to the group with the discussed recommendations.

John Olsen stated that for meaningful simplification the group cannot sit around and wait for federal legislation.

Mr. McCarthy commented that he can speak to the administrative costs of businesses trying to comply with tax law.

Mr. Perez said the group needs to look at the sourcing shift in jurisdictions.

10. Adjournment

Mr. Hunter adjourned the meeting at 4:02 p.m.